Order Code IB98048

CRS Issue Brief for Congress

Received through the CRS Web

Social Security Reform

Updated December 21, 1998

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SUMMARY

Although the Social Security system is now running surpluses of income over outgo, its board of trustees projects that its trust funds would be depleted in 2032 and only 73% of its benefits would be payable then with incoming receipts. They project that on average over the next 75 years, the system's cost would be 16% higher than its income; by 2075 it would be 48% higher. The primary reason is demographic: the post-World War II baby boomers will begin retiring in a decade and life expectancy is rising. By 2025 the number of people age 65 and older is predicted to grow by 75%. In contrast, the number of workers supporting the system would grow by only 12%. As a result, the ratio of workers to recipients is expected to fall from 3.4 to 1 today to 2.0 to 1 in 2030.

The trustees project that the surplus Social Security taxes now being collected will cause the Social Security trust funds — comprised exclusively of federal bonds — to a peak of $3.8 trillion in 2020. The system's outgo would thereafter exceed its income and the trust funds would fall until their depletion. However, the trustees also project that in 2013 the system's taxes (ignoring interest paid to the funds) would fall below its outgo. Interest paid to the funds is simply an exchange of credits among governmental accounts. It is not a resource for the government — only the system's taxes are. Hence, it is in 2013 that other federal receipts would be needed to help pay for benefits. At that point, if there are no other surplus receipts, policymakers would have three choices: raise taxes, cut spending, or borrow the needed money.

Mirroring this adverse outlook are public opinion polls showing that fewer than 50% of respondents are confident that Social Security can meet its long-range commitments. There also is a widespread perception that Social Security may not be as good a value in the future as it is for today's retirees. These concerns and a belief that the remedy lies partly in increasing national savings have led to proposals to totally revamp the system.

Others suggest that the system's problems are not as serious as sometimes portrayed. They argue that the system is now running surpluses, that the public still likes the program, and that there is risk in some of the new reform ideas. They contend that only modest changes are needed.

While the President has made Social Security reform a high priority, there is no "near-term" crisis to propel immediate action. In 1977 and 1983, when Congress addressed similar problems, the trust funds were projected to be exhausted in a very short time. Today, the problem is perceived to be a minimum of 14 or as much as 33 years away. Lacking a crisis, the pressure to compromise is diffused, and the divergent views about the issues have led to a myriad of complex proposals. In 1977 and 1983, the debate was about how to raise the system's income and/or constrain its expenditures. Today, the ideas range from restoring solvency with minimal alterations to totally replacing the system with something modeled after IRAs or 401(k)s. This broad spectrum was clearly reflected by the deliberations of a 1997 Social Security Advisory Council. Three very different plans were proffered, none of which was endorsed by a majority of the Council. Similar diversity is reflected in the more than 30 bills introduced in the 105th Congress to deal with the issue. The critical question is whether this diversity can be forged into a consensus plan.

MOST RECENT DEVELOPMENTS

In his January 1998 State of the Union address, the President pledged action to make Social Security more secure in the long run. He stated that he wanted to hold bipartisan forums around the country to draw out the public's views on the issues, have a White House Conference on Social Security in December, and convene congressional leaders early in 1999 to craft bipartisan legislation. He also urged the Congress to "reserve" use of any federal budget surpluses until action is taken to strengthen the system. Speaker of the House, Newt Gingrich, had suggested forming an intergenerational panel to conduct a national dialogue on the issues and a high-level commission to forge a bipartisan plan. This approach was reflected in H.R. 3546, passed by the House in April 1998; however, it was not acted on by the Senate before the 105th Congress adjourned.

In September 1998, the House passed H.R. 4578, a bill that would have created a "Protect Social Security Account" in the Treasury into which 90% of the next 11 years' projected federal budget surpluses would have been deposited pending Social Security reform. However, the Senate did not take up the bill before the 105th Congress adjourned. Supporters argued that the new account would ensure that budget surpluses would be available to help solve Social Security's financing problems. Critics contended that the measure was only symbolic and would do nothing substantive to save Social Security.

BACKGROUND AND ANALYSIS

Although the Social Security system is currently running annual surpluses of income over outgo, its board of trustees — comprised of three officers of the President's Cabinet, the Commissioner of Social Security, and two members representing the public at large — project that on average over the next 75 years Social Security's outgo will exceed its income by 16% and by 2032 its trust funds would be depleted. In 2032, only 73% of the benefits prescribed by current law would be payable with incoming revenues. The primary reason is demographic: an aging post-World War II "baby boom" generation will begin retiring in 10 years and increasing life expectancy is creating an older society. By 2025 the number of people age 65 and older is predicted to rise by 75%. In contrast, the number of workers whose taxes will finance future benefits is projected to grow by only 12%. As a result, the ratio of workers to recipients is projected to fall from 3.4 to 1 today to 2.0 to 1 in 2030.

Social Security revenues are paid into the U.S. Treasury and most of the proceeds are used to pay current benefits. Any surplus revenues are invested in federal securities recorded to the Old Age, Survivors, and Disability Insurance (OASDI) trust funds maintained by the Treasury Department (OASDI being the formal title for Social Security). Social Security benefits and other costs are paid out of the Treasury. Whenever current Social Security taxes are insufficient to pay benefits, the Treasury makes up the difference with other receipts and securities held by the trust funds are redeemed (or written off).

Currently, more Social Security taxes are being paid into the Treasury than are needed to pay the benefits. These surpluses and the interest the government "pays" to the trust funds on the securities they hold appear as growing trust fund balances. In their April 1998 report, the trustees projected that the balances would grow to a peak of $3.8 trillion in 2020. After 2020, the system's income would exceed its outgo and the balances would fall. In 2032, the trust funds would be totally depleted and the system would be technically insolvent.

Although the system's income is projected to exceed its outgo through 2020, the point at which Social Security taxes alone (ignoring interest paid to the trust funds) would fall below the system's outgo is 2013. Since interest paid to the funds is simply an exchange of credits among Treasury accounts, it is not a resource for the government — only the system's taxes are. Hence, it is in 2013 that other federal receipts would be needed to help meet the system's costs. At that point, if there are no other surplus receipts, policymakers would have three choices: raise taxes, cut spending, or borrow the needed money.

The Projections of "Actuarial Imbalance"

- Spending exceeds tax revenues in 2013
- Combined OASDI trust funds peak in 2020
- DI fund becomes exhausted in 2019
- OASI fund becomes exhausted in 2034
- Combined OASDI trust funds become exhausted (have a zero balance) in 2032

Today, the cost of the system of nearly $400 billion is equal to 11.2% of the total amount of national earnings subject to Social Security taxation, what is referred to as taxable payroll. It is projected to rise slowly over the next 12 years, reaching 12.2% by 2010. It would then begin a more precipitous rise over the next 25 years to 15.2% in 2025 and 18.2% in 2035. This would be near the end of the baby boomers' retirement as those born in 1965 (the approximate end of the baby boom) would be 70 years old in 2035. After that, the system's cost would rise very slowly to 19.8% of payroll in 2075. The average cost of the system over the trustees' 75-year projection period would be 15.6% of payroll or about 16% higher than the system's average income. However, the gap between income and outgo would grow continuously and by 2075, it would equal 6.4% of payroll (income would equal 13.4% and outgo, 19.8%). Simply put, by 2075, outgo would exceed income by 48%.

Mirroring this adverse outlook are public opinion polls showing that fewer than 50% of respondents express confidence that Social Security can meet its long-range commitments. Accompanying this skepticism is a growing perception that Social Security may not be as good a value in the future as it is for today's retirees. Until recent years, a typical retiree could expect to receive far more in benefits than he or she paid in Social Security taxes. However, because Social Security tax rates have increased to cover the costs of a maturing "pay-as you-go" system, it has become increasingly apparent that these favorable ratios will not continue in the future. These concerns and a belief that the remedy lies partly in increasing national savings have led to a number of major reform proposals.

Others suggest that the issues confronting the system are not as serious as sometimes portrayed. They point out that there is no imminent crisis, that the system is now running surpluses and is projected to do so for two decades or more, that the public still likes the program, and that there is considerable risk in some of the new reform ideas. They contend that modest changes could be enacted to resolve the long-range funding problem.

The Basic Debate

The current problem is not unprecedented. In 1977 and 1983, Congress enacted a variety of measures to address financial problems similar to those now being forecast. Among them were constraints on the growth of *initial* benefit levels, a gradual increase from 65 to 67 in Social Security's *normal retirement age* (i.e., the age for receipt of full benefits), increases in payroll taxes, partial taxation of the Social Security benefits of higher-income recipients, and extension of coverage to federal and non-profit workers. Since that time, new long-term deficits have been forecast, resulting from changes in actuarial methods and assumptions, as well as extensions of the 75-year valuation period to later years (adding years of deficits at the back end of the period, while subtracting out recent years of surpluses).

A consensus appears to have emerged that action should be taken soon. It has been the expressed view of the Social Security trustees and other recent panels and commissions that have examined the problem, and was echoed by a wide range of interests groups testifying in hearings held across a number of Committees in the 105th Congress. However, one of the difficulties in moving forward is that there is no sense of "near-term" crisis. In 1977 and 1983, the trust funds' balances were projected to fall to zero in a very short time, within months of the 1983 rescue. Today, the problem is perceived to be a minimum of 14 or as much as 33 years away. Lacking a "crisis," the pressure to compromise is diffused and the issues and the divergent views about them have led to a myriad of complex proposals. In 1977 and 1983, the debate was not about fundamental reform; it revolved around how to raise the system's income and/or constrain its expenditures. Today, the ideas range from restoring the system's solvency with as few alterations as possible to totally replacing it with something modeled after IRAs or 401(k)s. This broad spectrum was clearly reflected in the 1997 Advisory Council's report, which presented three very different reform plans, none of which received endorsement by a majority of the Council's 13 members. Similar diversity is reflected in the more than 30 bills introduced in the 105th Congress to deal with the issue.

The Push for Major Reform. Advocates of major reform see Social Security as an anachronism, largely built on depression-era concerns about high unemployment and widespread "dependency" among the aged. They see the prospect of reform today as an opportunity to modernize the way society sets money away for retirement. They cite the vast economic, social, and demographic changes that have transpired over the past 60 years and point to changes made in other countries that now use market-based personal accounts as a way not only to strengthen retirement incomes but to bolster their economies by spurring savings and investments. They view government-administered, pay-as-you-go systems as politically unsustainable when increasingly larger segments of population have to draw on them. They prefer a system of personal accounts that have people invest while they work for their own eventual retirement, in contrast to a system that would impose tax hikes on future workers to meet the financing burden of a pay-as-you-go system.

They also see it as a way of countering skepticism about the current system by giving workers a greater sense of ownership of their retirement savings. They contend that private investments would yield higher retirement incomes since stocks and bonds generally have provided higher returns than are projected from the current system. Some feel that a system of personal accounts would correct what they see as Social Security's contradictory mix of insurance and social welfare goals — that its benefits are not based strictly on a person's contributions, yet because it is not means-tested, many of its social benefits go to well-to-do recipients. Still others argue that creating a system of personal accounts would prevent the government from using surplus Social Security taxes to "mask" government borrowing or spending (i.e., hide budget deficits in the rest of the government).

Others, not necessarily seeking a new system, see enactment of long-range Social Security constraints as one element of curbing federal entitlement spending. The declining ratio of workers to Social Security recipients (dropping from 3.4 to 1 today to 2.0 to 1 in 2030) is a manifestation of the broader decline in the ratio of the working age population to the largest group who will draw on entitlement programs, the elderly. The number of people aged 20-64 to those 65 and older is projected to fall from 5.1 to 1 in 1980 to 2.8 to 1 in 2030. With costs directly linked to an aging population, Social Security, Medicare, and Medicaid — the "big three" entitlements — are expected to grow rapidly. Proponents of imposing constraints on them fear that if left unchecked, their costs will place a large strain on the federal treasury far into the future, limiting policy options and forcing future generations to bear a much higher tax burden.

Some contend that action is needed now as a matter of *fairness*. They point out that many of today's recipients get back more than they paid in Social Security taxes and far more than the baby boom generation will get. They argue that to put off making changes until some later point when the financial stress is severe is unfair to today's workers who must pay for "overgenerous" and non-targeted "transfer" payments with the prospect that their own benefits will have to be greatly scaled back.

Still others simply emphasize the trustees' adverse projections and contend that steps need to be taken today — raising Social Security's retirement age, scaling back its benefits, cutting COLAs, raising taxes, etc. — so that whatever is done can be phased in, giving today's workers time to adjust their retirement expectations to reflect what these programs will be able to provide. Waiting, they fear, would require abrupt changes in taxes and benefits.

The Arguments for Retaining the Existing System. Those who favor a more restrained approach argue that the current "crisis" atmosphere about the need to reform the system undermines public support for it. They contend that its problems are resolvable with modest tax and spending changes and that the programs' critics are raising the specter that it will "bankrupt the Nation" as an excuse to privatize it. They contend that a system of personal savings accounts would erode the social insurance nature of the current system that favors low-income workers, survivors, and the disabled.

Others are concerned that switching to a new system of personal accounts would pose large transitional problems by requiring today's younger workers to save for their own retirement while paying taxes to cover current retirees' benefits. Some doubt that it would increase national savings, arguing that increased governmental borrowing (resulting from diversion of current payroll taxes to new personal accounts) would offset the increased personal account savings. They also contend that the capital markets' inflow created by the accounts would make the markets difficult to regulate and potentially distort equity valuations. They point out that some of the other countries who have moved to personal accounts did so to create capital markets. Such markets, they argue, are already well developed in the United States.

Still others argue that a system of personal accounts would expose participants to excessive market risk for an income source that has become so essential to so many. They contend that the Nation now has a three-tiered retirement system — consisting of Social Security, private pensions, and personal assets — that already has private savings and investment components. They contend that while people may want and be able to undertake some "risk" in the latter two tiers, they argue that Social Security — as the tier that provides a basic floor of protection — should not be conditioned on market risk. They further contend that the administrative costs of maintaining a system of personalized accounts could be very large and could significantly erode the returns people would realize.

Some say that concerns about growing entitlements are overblown, contending that as people live longer, they will work longer, and that as relatively fewer younger people enter the workforce, there will be labor market inducements for older people to remain on the job. Moreover, immigration policy can also be used as a way to increase the labor force, if desired. They argue that the projected low ratio of workers to dependents is not unprecedented; it existed when the baby boomers were in their youth. They point out that the baby boomers are now in their prime working and savings years and contend that the Nation's savings rate will rise as the baby boomers age.

They also caution that too much is being inferred from polling data, noting that public understanding of Social Security and some of the reform ideas is limited and often wrong. They argue that a major reason confidence is highest among the retired is that they know more about the program. Younger workers, who are more skeptical, receive little information about Social Security unless they request it, which very few do.

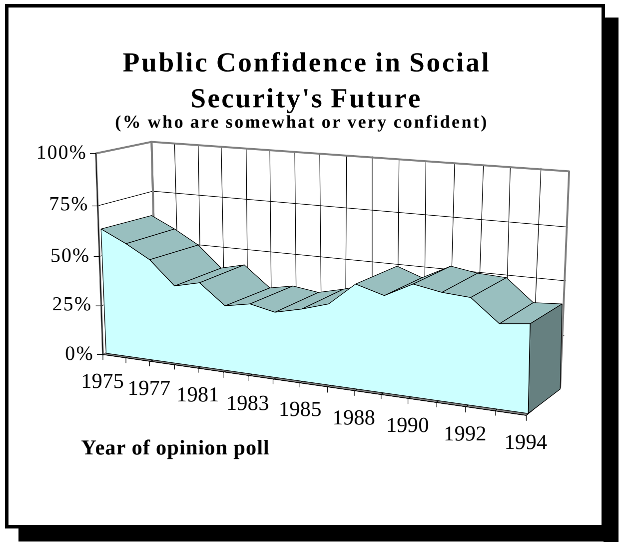
The Basic Choices. The pursuit of a remedy to Social Security's problems does not suffer from a lack of options. To the contrary, the three alternatives offered by the recent Social Security Advisory Council show that the range of choices is wide — from maintaining the current system to the maximum possible extent, to reducing its future commitments while mandating that workers save more on their own, to restructuring Social Security into a new two-tiered system, a major part of which would be the creation of new personal accounts. The critical question is whether the diverse views can be forged into a consensus plan. The emerging consensus is that action needs to be taken quickly, before the next Presidential election cycle begins. Whether that is enough time for the public to absorb and express a preference for the basic choices is uncertain.

Areas of Contention

The System's Financial Outlook. While adverse trustees' projections have persisted and grown larger over the past 10 years (the system's average 75-year shortfall has grown from 5% of its income in the 1989 trustees' report to 16% in the latest report), there are conflicting views over the severity of the problem. Those most concerned about it argue that the average shortfall of 16% masks the real imbalance. They point out that the system's costs are projected to exceed its receipts by 4.66% of taxable payroll in 2030 — or, in layman terms, by 36%. In 2075, it would be 6.43% of taxable payroll, or 48%. Simply put, on a pay-as-you-go basis, the system will need a lot more than a 16% change in taxes or expenditures to be able to meet its commitments. They contend that thinking the problem is 34 years away (i.e., because the trust funds would not be depleted until 2032) ignores the financial pressure the system will place on the government much sooner. They argue that it will emerge when surplus Social Security taxes start to decline in the 2005-2010 period, or when the system's expenditures exceed its taxes in 2013. It is at that point that the government would have to use other resources to help pay the benefits — resources that would otherwise be used to finance other governmental functions. They also argue that looking only at Social Security's imbalance ignores the large financial strain that other entitlement programs — notably Medicare and Medicaid — will impose on the government. They argue that as the ratio of the working age population to the elderly drops, the burden on workers will rise significantly. Thus, they view the problem not only in terms of the system's actuarial imbalance but by the large increase in expenditures it and other entitlement programs will create because of the looming demographic changes.

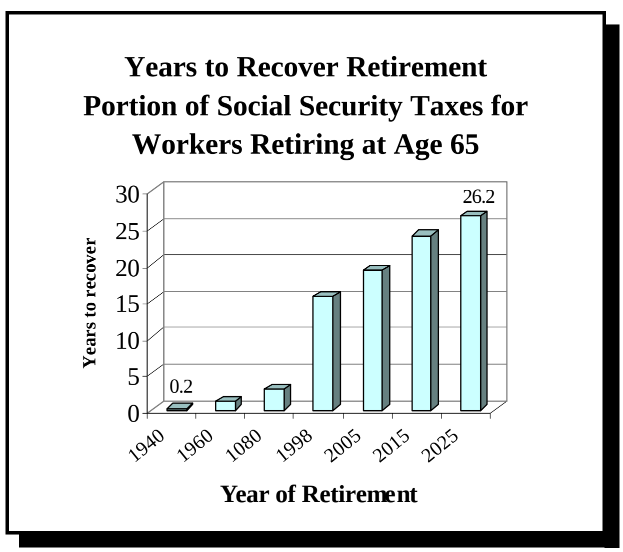
Others express concern that the problem is being exaggerated. First, they argue that in contrast to earlier episodes of financial distress, the system has no immediate problem. Surplus tax receipts are projected for 15 years and the trust funds are projected to have a balance for 34 years. They contend that projections 75 years into the future cannot be viewed with any significant degree of confidence and Congress should respond to them cautiously. They argue that even if the projections held, the average imbalance could be eliminated by raising the tax on employees and employers by only one percentage point of pay (if started today). They contend that the real problem is that the government is now spending Social Security surpluses on other programs. They point out that as a share of GDP, the projections show the system's cost only rising from 4.6% today to 6.8% in 2030; including Medicare, it rises from 7.2% to 12.6%. While acknowledging that this would be a notably larger share of GDP, they argue that GDP itself would have risen by more than 50% in real terms. Moreover, while the ratio of workers to recipients is projected to decline, they contend that employers are likely to respond with inducements for older workers to stay on the job longer. "Transitioning" to retirement and bridge jobs already are becoming more prevalent and older workers are increasingly seeing retirement as something other than an all or nothing decision.

Public Confidence. Social Security's financial problems are mirrored in general skepticism about the system. Public confidence in the system's ability to meet its long-run commitments dropped after funding problems emerged in the 1970s and early 1980s. Repeated polling done over the past 20 years, under the sponsorship of the American Council of Life Insurance, shows a majority of Americans express a lack of confidence in the system. Although skepticism abated for a few years following the 1983 legislation shoring up the system, it appears to have risen again in recent years with 55% voicing a lack of confidence in 1994. Younger workers were particularly skeptical; nearly two-thirds of those below age 55 voiced little confidence, compared to less than one-third of those 55 and older.



Some observers caution about inferring too much from polling data, noting that public understanding of Social Security is limited and often inaccurate. They argue that a major reason confidence is highest among the retired and those nearing retirement is that, being more immediately affected, they have learned more about the program. Younger workers receive little information about Social Security unless they request it, which very few do. In 1995, the Social Security Administration began phasing in a system to provide annual statements to workers, which some argue will make workers more aware of their promised benefits and thus more trusting of the system.

Others, however, suggest the skepticism is justified by the system's repeated financial difficulties and its diminished "money's worth" to younger workers. Notably, in recent polls reform of Social Security ranked high as a legislative priority. A survey conducted in October 1997 for NBC News and the Wall Street Journal showed that 66% of the respondents ranked reform of Social Security as a "top priority" for the Congress.



Increasing Doubts About Money's Worth. Until recent years, it was clear that Social Security recipients received a very good deal for the Social Security taxes they paid. Most received more, often far more, than the value of those taxes. However, because Social Security tax rates have increased over the years and the age for full benefits is scheduled to rise, it is becoming increasingly apparent that Social Security will be less of a good deal for many future recipients. For example, for workers who earned average wages and retired in 1980 at age 65 it took 2.8 years to recover the value of the retirement portion of the combined employee and employer shares of their Social Security taxes plus interest. For their counterparts who retired at age 65 in 1998, it will take 15.5 years. For those retiring in 2025, it will take 26.2 years (based on the trustees' intermediate forecast.)

Some observers feel these discrepancies are inequitable and endanger public support for the system. Others, however, discount their importance, arguing that Social Security is a social insurance program serving social ends that transcend questions of whether some individuals do better than others. For example, the program's anti-poverty features by design replace a higher proportion of earnings for low-paid workers and provide additional benefits for workers with families. Also, today's workers, who will receive less direct value from their taxes than today's retirees, have in large part been relieved from having to support their parents, and the elderly are able to live independently and with dignity. These observers contend that the societal worth of these aspects of the system is not valued in calculations of taxes paid and benefits received.

"Privatization" Debate. Concerns about Social Security's financing problems, skepticism about its survival, and a belief that economic growth could be bolstered through increased savings have led to a number of proposals to "privatize" part or all of the system, reviving a philosophical debate that dates back to its creation in 1935. The three alternative plans of the recent Advisory Council all featured some program involvement in the financial markets. The first, the "maintain benefits" plan, called upon Congress to consider authorizing investment of part of the Social Security trust funds in equities (the assumption being that stocks would produce a higher return than the Treasury bonds the system now invests in). The second, the "individual account" plan, would have required workers to contribute an extra 1.6% of their pay to new personal accounts to make up for Social Security benefit cuts it called for to restore long-range solvency. The third, the "personal security account" plan, would have redesigned the system by gradually replacing Social Security retirement benefits with flat-rate government benefits based on length of service and personal accounts funded with 5% of worker's pay (much of which would be in place of current Social Security taxes).

Another approach garnering considerable attention is the reform that Chile enacted in 1981. It replaced a troubled state-run, pay-as-you-go system with one requiring most workers to invest part of their earnings in personal accounts through government-approved pension funds. Similar approaches for reforming the U.S. system, and scaled-down versions that would run in conjunction with the existing system, were introduced in the 104th and 105th Congresses. They would permit or require that workers invest some or all of their Social Security taxes into personal accounts. These include bills by Senators Kerrey and Simpson (S. 824 and S. 825), and Representatives Porter (H.R. 2953), Thomas (H.R. 2971) and Nick Smith (H.R. 3758) in the 104th Congress, and by Senators Gregg (S.321), Moynihan (S. 1792), Gregg and Breaux (S. 2313), and Grams (S. 2552), and Representatives Sanford (H.R. 2768 and H.R. 2782), Porter (H.R. 2929), Nick Smith (H.R. 3082) and Pete Sessions (H.R. 3683) in the 105th. S. 824, S. 1792, S. 2552, H.R. 2768, H.R. 2929, H.R. 2953, H.R. 3082, H.R. 3758, and H.R. 3683 call for voluntary systems; S. 321, S. 825, S.2313, H.R. 2782, H.R. 2971, and H.R. 4256 envision mandatory ones. To compensate for the revenue losses, most of these bills call for future Social Security benefits to be reduced or forfeited.

Still another approach, reflected in H.R. 3456 (Kasich) and S. 2369 (Roth) would require that future budget surpluses be used to set up personal accounts to supplement Social Security benefits for those who currently pay Social Security taxes. They proposed no changes to the existing system.

Yet another approach is reflected in H.R. 336 (Solomon), which would create an investment board empowered to invest surplus Social Security funds in stocks and bonds as well as government securities. This is similar to the approach suggested in the Advisory Council's "maintain benefits" plan.

Many proponents of moving to personal accounts see it as a way of reducing future demands for governmental financing and countering skepticism about the existing system by giving workers more of a sense of ownership of their retirement savings. Others feel that it would yield a better retirement income for workers since stocks and bonds generally have provided higher rates of return than are projected from Social Security. In concert with this, they argue it would increase national savings and promote economic growth. Some feel it would correct what they see as Social Security's contradictory mix of insurance and social welfare goals — that its benefits are not based strictly on a person's (and his or her employer's) contributions as a personal account would be, yet because Social Security is not means-tested, many of its social benefits go to well-to-do recipients. Still others argue that it would prevent the government from using surplus Social Security revenues to "mask" public borrowing or avoid raising taxes or cutting other spending. Generally, proponents of personal accounts oppose investing the Social Security trust funds in the markets because they fear it would concentrate too much economic power in a government-appointed board.

Opponents of personal accounts argue that Social Security's problems can be resolved without altering its fundamental nature. They fear that creating personal accounts in place of Social Security benefits would erode the social insurance nature of the current system that favors low-wage earners, survivors and the disabled. Others are concerned that it would pose insurmountable transitional problems by requiring today's younger workers to save for their own retirement while simultaneously supporting current retirees. Some doubt that it would increase national savings, arguing that increased governmental borrowing would offset the increased private savings. They also fear that the investment pool created by the accounts could be difficult to regulate and could be potentially distort capital markets and equity valuations. Still others argue that it would expose participants to excessive market risk for something as essential as core retirement benefits and, unlike Social Security, which provides annual cost-of-living adjustments, would provide poor protection against inflation. They prefer "collective" investment of the Social Security trust funds in the markets to potentially bolster their returns and spread the risks of poor performance broadly.

The Retirement Age Issue. There has been considerable interest in recent Congresses in raising the ages at which full and reduced Social Security retirement benefits are payable as a means to address the system's long-range problem. Much of it stems from improvements in life expectancy since Social Security benefits were first paid in 1940. Back then an average 65 year old was expected to live another 13 years. Today, life expectancy at 65 is 17 years, and by 2030 it is projected to be 19 years. This trend made increasing Social Security's "full benefit" age an attractive means of achieving savings when the system was facing major financial difficulties in the early 1980s. Congress boosted the "full benefit" age from 65 to 67 as part of the Social Security Amendments of 1983 (P.L. 98-21). This change will be phased in starting with those born in 1938, with the full 2-year hike affecting those born after 1959. It will not raise the first age of eligibility — which is age 62 — but the benefit reduction for retiring at 62 will rise from 20% to 30%. Proponents of raising one or both of these ages further see it as reasonable in light of past and projected longevity improvements. Opponents say it will penalize today's workers who already get a worse deal from Social Security than do current retirees, those who work in arduous occupations, and those who are members of racial minorities that have relatively shorter life expectancies.

Cost-of-living adjustments (COLAs). Social Security benefits and those of a number of other major entitlement programs, as well as various aspects of the income tax system, are adjusted annually to reflect inflation. Social Security accounts for 80% of the federal spending on COLAs. These COLAs are based upon the Bureau of Labor Statistics' (BLS) Consumer Price Index (CPI). It measures price increases for selected goods and services provided in the economy, rather than the cost of living *per se.* In recent years the CPI has come under criticism for allegedly overstating the effects of inflation, notably because the market basket of goods and services underlying the index was not being revised regularly to reflect changes in consumer buying preferences or improvements in quality. A BLS analysis in 1993 found that the overstatement might be as much as 0.6 of a percentage point annually, while cautioning that measuring the error precisely may prove to be extremely difficult. CBO estimated in 1994 that the overstatement ranged from 0.2 to 0.8 of a percentage point. A 1996 panel studying the issue for the Senate Finance Committee argued that the overstatement might be 1.1 percentage points.

In response to its own analysis as well as the outside criticisms, the BLS has made various revisions to the CPI. To some extent, these revisions may account for part of the slower CPI growth seen in recent years. However, calls for adjustments continue. According to the SSA actuaries, a COLA reduction of 1.0 percentage point annually beginning in 1998 would eliminate almost two-thirds of Social Security's long-range deficit. While some view further CPI changes as necessary to help keep Social Security and other entitlement expenditures under control, others contend that changing the measurement of the CPI is really a backdoor way of cutting benefits. They argue that the market basket of goods and services purchased by the elderly is different from that of wage earners and salaried workers (around whom the CPI is constructed). It is more heavily weighted with health expenditures, which rise notably faster than the overall CPI, and thus they contend that the cost of living for the elderly is higher than reflected by the CPI.

Social Security and the Budget. Social Security is by law considered to be "off budget" for many key aspects of developing and enforcing budget policies and goals set each year by Congress. However, it is still a federal program and its income and outgo help to shape the year-to-year financial condition of the government. Hence, fiscal policymakers continue to focus on "unified" or overall budget figures that include Social Security. With the President urging in his January 1998 State of the Union address that newly emerging "unified" budget surpluses be reserved until Social Security's problems are resolved, the program's treatment in the budget has emerged as a major policy issue. Congressional views about what to do with the budget surpluses are diverse — ranging from "buying down" the outstanding federal debt to cutting taxes to increasing spending. However, support for the President's proposition was strong and to a large extent made Social Security reform a place holder in much of the past year's fiscal policy debate.

The House Republican leadership attempted to set alternative parameters with introduction and passage of a tax cut bill, H.R. 4579, and a companion measure, H.R. 4578, that would have created a new Treasury account (the "Protect Social Security Account") to which 90% of the next 11 years' projected surpluses would have been credited pending Social Security reform. The underlying principle suggested that 10% of the surpluses be used for tax cuts and the remainder held in abeyance until Social Security reform was enacted. However, both bills were heavily opposed by Democratic Members, who argued for 100% of the surpluses being held in abeyance pending Social Security reform. The Senate did not take up either measure before the 105th Congress adjourned.

Earlier in the 105th Congress Social Security became an issue in consideration of a constitutional amendment to require a balanced federal budget. The amendment (H.J.Res. 1 and S.J.Res. 1) would have included Social Security in the budget calculations, as did similar measures considered in 1995 and 1996. Opponents of including Social Security argued that it would cause the program's surpluses to be used to cover deficits in the rest of the budget and could lead to future cuts in Social Security benefits. Those who wanted to keep it in the calculations argued that it was not their purpose to cut Social Security, but that the program represented too large a share of federal revenues and expenditures to be ignored and that removing it from the calculations would make the goal of achieving a balanced budget much more difficult. On each occasion, critics of the amendment attempted to remove Social Security from the calculations. While these attempts failed, the balanced budget amendment itself failed each time to get the requisite votes in the Senate.

Congressional Initiatives

Over the past several years a large number of bills have been introduced to deal with the issues. During the 103rd Congress, bills were introduced proposing to raise the system's full benefit age to 70, modify COLAs, and/or make other benefit reductions — H.R. 4275 (Pickle), H.R. 4372/H.R. 4373 (Penny), H.R. 5308 (Nick Smith), and S. 818 (Kerrey). H.R. 4245 (Rostenkowski) of the same Congress sought a mix of benefit reductions and tax increases. In the 104th Congress, more far-reaching proposals were introduced encompassing not only some of these changes, but also seeking to privatize a portion of the program — S. 825 (Kerrey and Simpson) and H.R. 3758 (Nick Smith).

Although the recent Social Security Advisory Council could not reach a consensus on a single approach, its 1997 report contained three different plans to restore the system's solvency. The first (the "maintain benefits" plan) would have kept the system's benefit structure essentially the same as current law by addressing most of the problem with revenue increases (including an eventual rise in the payroll tax) and minor benefit cuts. To close the remaining gap, its proponents suggested that Congress consider authorizing investment of part of the Social Security trust funds in the stock market. The second (the "individual account" plan) addressed the problem mostly with benefit reductions, and in addition would have required workers to make an extra 1.6% of pay contribution to new personal accounts. The third (the "personal security account" plan) proposed a major redesign of the system that would have gradually replaced the current earnings-related retirement benefit with a flat-rate benefit based on length of service and personal accounts funded with a 5% of pay contribution (carved out of the current payroll tax). It would have covered the costs of transitioning to the new system with a 1.52% of pay increase in payroll taxes and government borrowing. While Congress has not taken action on any of the Advisory Council plans, the Council's report and its varied plans have served to stimulate public discussion and debate, and the conceptual approaches they reflect can be found in one or more of 30 reform bills introduced in the 105th Congress and other proposals suggested by private panels and experts.

Reform Bills and Other Proposals in the 105th Congress. One group of proposals would attempt to restore the system's solvency with some combination of benefit restraints and income-producing measures. All would make some use of the nation's financial markets. Most would do so by permitting or mandating the creation of new personal savings accounts to supplement or take the place of a portion of future Social Security benefits; others would require or permit the investment of the Social Security trust funds in the financial markets. A second group would replace the current system with one comprised of new personal accounts. Some would phase-in rapidly, giving workers so-called recognition bonds for their past Social Security taxes, while others call for a long transition. A third group would require or permit the creation of personal accounts in anticipation that additional retirement income may be needed to offset changes enacted at some later time to restore the system's solvency. They do not contain specific measures to alter Social Security. A fourth group would alter the Social Security trust funds' investment policies or otherwise create special Treasury accounts to earmark budget surpluses pending Social Security reform. Finally, a fifth group would create new bi-partisan panels to devise reform plans. The following briefly summarizes the major elements of a number of these proposals.

S. 321 (Gregg) and H.R. 2782 (Sanford) would mandatorily divert one percentage point of the Social Security tax rate on workers into new personal savings accounts (for those under age 55 upon enactment) managed by the Treasury in the same manner as the federal workers' Thrift Savings Plan (with the same investment options) or by banking institutions. Future Social Security benefits would be scaled down to take account of the growth of the accounts. They also gradually raise Social Security's early and full retirement ages to 67 and 70, respectively (thereafter increasing them by about one month every 2 years), and beginning in 1998, reduce COLAs.

S. 1792 (Moynihan/Kerrey) would put the current system on a pay-as-you-go basis by immediately reducing the tax rate by one percentage point each on workers and their employers, and then raising it later in tandem with the system's future cost. Workers would be given the option of using the tax cut to create new personal accounts. If they did, their employers would have to match their contributions. The bill also would reduce COLAs, increase and extend the taxation of benefits to all recipients, gradually raise the full benefit age to 70, lengthen the earnings "averaging period" for computing benefits, eliminate the Social Security earnings test (allowing recipients to receive benefits regardless of their earnings), raise the maximum amount of earnings subject to taxation, and extend Social Security coverage to all newly hired State and local government workers.

S. 2313 (Gregg/Breaux) and H.R. 4256/H.R. 4824 (Kolbe/Stenholm) would mandatorily divert two percentage points of the Social Security tax rate on workers into new personal accounts (for those under age 55 upon enactment). They raise the existing system's income by extending Social Security coverage to newly-hired state and local government workers and crediting proceeds from the current income tax on benefits to the Social Security trust funds that now go to the Medicare Hospital Insurance trust fund. They reduce its outgo by raising the early and full benefit ages gradually to 67 and 70, thereafter increasing them by 2 months every 3 years, altering the basic benefit formula to produce lower benefits, reducing the dependent spouse's benefit, lengthening the earnings averaging period for computing benefits, and reducing Social Security COLAs. The bills also would create a new system of minimum Social Security benefits and eliminate the Social Security earnings test for recipients at or above the full retirement age.

Senator Phil Gramm suggested a plan under which workers would be allowed to divert three percentage points of their Social Security tax rate into new personal accounts with the government guaranteeing a higher retirement income than would be payable from Social Security alone. The guarantee would apply when a retiree's Social Security benefits plus an annuity from the new personal accounts are less than 120% of current law Social Security benefits. Federal budget surpluses, a partial drawdown of the Social Security trust funds, and higher corporate tax receipts resulting from the potential economic stimulus created by the plan were suggested as ways of covering transition costs. The Senator suggested that the plan might resolve Social Security's funding problems since the personal account annuities would fully or partially offset Social Security benefits.

H.R. 2768 (Sanford) and H.R. 2929 (Porter) would allow workers to divert eight and ten percentage points, respectively, of the combined OASI tax rate on employees and employers into new personal accounts. Under H.R. 2768, workers who opt for the new system would receive Social Security benefits equivalent to what they would have received had they turned age 62 and retired in the year 2000 and a minimum annual annuity from their new accounts. For those remaining in the existing system, the bill would gradually raise the full benefit age to 70, alter the basic benefit formula to produce lower benefits, reduce annual COLAs and spousal benefits, and extend Social Security coverage to newly hired state and local government workers. Under H.R. 2929, workers opting for the new system would receive Social Security benefits (through so-called recognition bonds) based on their employment record before they joined and a minimum annuity from their new personal accounts. For those remaining in the existing system, it would gradually raise the full benefit age to 70 and alter the basic benefit formula to produce lower benefits.

H.R. 3082 (Nick Smith) would allow workers to put a share of their Social Security taxes into new personal accounts based on the yearly excess of Social Security revenue over expenditures and one-third of any federal budget surplus. At retirement, each participant's Social Security benefits would be reduced by the amount of a hypothetical annuity payable from their accounts. The bill alters the existing system by gradually raising the early and full benefit ages to 66 and 69, respectively, altering the basic benefit formula to produce lower *initial* benefits, reducing spousal benefits, withholding benefits from higher income recipients who are projected to receive more from Social Security than they and their employers paid in Social Security taxes, and extending Social Security coverage to newly hired state and local government workers. H.R. 3560 (Nick Smith), a companion bill to H.R. 3082, would create a 10-year "pilot" program of voluntary personal accounts for workers age 16 to 20. For those who participate, the bill would have the federal government deposit amounts equal to 2.5% of their pay (up to $2,000 a year) into the new accounts. At retirement, their Social Security benefits would be reduced by an annuity payable from 50% of the assets in their accounts.

H.R. 3683 (Sessions) and S. 2552 (Rod Grams) would allow workers to opt out of the current system if they elect to set up new personal accounts. Under H.R. 3683, once a worker opted out, his or her portion of the Social Security tax — 6.2% of pay — would be deposited into a new personal account. Employers would continue to pay their share of the tax to the existing system for 15 years, after which they would contribute to the worker's personal account. There would be a 90-day period of dual coverage, after which the worker's Social Security coverage would decline by 20% per year until all protections were forfeited in the 5th year. S. 2552 would allow workers to divert five percentage points of the 6.2% tax rate into new personal accounts with employers contributing a matching amount of their taxes — a total of 10% of pay. Workers age 30 and older would receive "recognition bonds" for past Social Security taxes. Those choosing the new system could opt back into the old one within 10 years upon repayment of the taxes and any recognition bonds received.

Economists Martin Feldstein and Andrew Samwick also suggested a personal accounts system funded with federal budget surpluses allocated to workers at a rate equal to 2% of their pay. Under their plan, withdrawals from the accounts would cause a partial reduction in Social Security benefits; i.e., for every $1 withdrawn, $.75 in Social Security benefits should be forfeited. In this way, the build up of the accounts would lead to an eventual reduction in the existing system's cost while enhancing future retirees' income. They claim the proposal would make the existing system solvent in the long run.

Not all proposals attempt to close the system's funding gap. Although differing in detail, H.R. 3456 (Kasich) and S. 2369 (Roth) would create personal accounts funded with federal budget surpluses that would be considered supplements to Social Security for those who pay Social Security taxes. These proposals assume no changes to the existing system. The expressed view is that Social Security will have to be changed at some point, and the creation of these accounts could help fill the gap in benefits caused by those eventual changes. A similar approach, reflected in H.R. 1611 (Petri), would permit people born after June 30, 1998, who are otherwise eligible for deductible IRAs, to create personal accounts.

Yet another approach would create an investment board empowered to invest surplus Social Security funds in stocks and bonds as well as federal securities. It would use equities to attempt to bolster the investment return of the Social Security trust funds. The idea is that a managed fund that took advantage of investment yields from stocks and marketable bonds would raise the investment income of the trust funds. This is similar to the approach suggested in the Advisory Council's "maintain benefits" plan, and is reflected in H.R. 336 (Solomon). It also is being promoted by former Social Security commissioner, Robert Ball, and Brookings economists, Henry Aaron and Robert Reischauer. A similar, but much more limited, approach is reflected in H.R. 2191 (Neumann). It calls for replacement of the non-marketable Treasury securities now held by the trust funds with marketable federal securities purchased by the Treasury with federal budget surpluses. He proposed this as one element of a three-part plan to prioritize the use of the projected budget surpluses.

LEGISLATION

H.R. 3546 (Archer et.al.)

Would form panel to conduct a *national dialogue* and a commission to forge a bipartisan plan. Passed House April 29, 1998. No action taken by Senate.

H.R. 4578 (Archer et. al.)

Would create a "Protect Social Security Account" in the Treasury into which 90% of the estimated budget surpluses for the next 11 years would be deposited pending Social Security reform. Passed House September 25, 1998. Subsequently inserted in House-passed H.R. 4579, the Taxpayer Relief Act of 1998. No action taken by Senate.

FOR ADDITIONAL READING

CRS Report 98-750, *Social Security Reform: Bills in the 105th Congress and Other Proposals*, by David Koitz, Geoffrey Kollmann, and Dawn Nuschler.